

Message Text

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ACTION SS-25

INFO OCT-01 ISO-00 SSO-00 NSCE-00 /026 W

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O 141429Z JAN 75

FM AMEMBASSY TEL AVIV

TO SECSTATE WASHDC IMMEDIATE 5227

C O N F I D E N T I A L SECTION 1 OF 2 TEL AVIV 0279

EXDIS

E.O. 11652: GDS

TAGS: EAID, IS

SUBJ: ISRAEL'S FY-76 ASSISTANCE REQUEST

REF: A. TEL AVIV 0143, JAN 9, 1975

B. TEL AVIV 4734, AUGUST 20, 1974

C. TEL AVIV 7369, DECEMBER 20, 1974

D. TEL AVIV 0151, JAN 9, 1975

1. SUMMARY. THIS YEAR'S " BLUE PAPER," WHICH IS SIXTH IN SERIES OF ANNUAL STATEMENTS OF ISRAEL'S REQUIREMENTS FOR US ASSISTANCE, PRESENTS PESSIMISTIC OUTLOOK FOR ISRAELI ECONOMY. PAPER CONCLUDES WITH FORECAST OF \$2.59 BILLION " UNCOVERED FOREIGN EXCHANGE DEFICIT" IN 1976 WHICH GOI HOPES WILL BE COVERED BY USG (ALL FIGURES ON CY BASIS UNLESS OTHERWISE NOTED). SHARPLY ACCELERATING AID REQUESTS ARE LARGELY RESULT HIGH LEVEL OF DEFENSE IMPORTS WHICH ARE PROJECTED AT \$2.45 BILLION IN 1976. THUS, BASIC CONSIDERATION IS WHETHER THIS LEVEL OF MILITARY IMPORTS IS JUSTIFIED IN TERMS US OBJECTIVES. IF SO, CASE CAN THEN BE MADE FOR MASSIVE ASSISTANCE FROM US TO HELP FINANCE THESE IMPORTS. WORLD RECESSION HAS REDUCED ISRAELI BOND SALES AND COLLECTIONS ABROAD AND FURTHER BELT-TIGHTENING AT HOME, WHILE POSSIBLE, WOULD REDUCE BALANCE OF PAYMENTS DEFICIT BY ONLY LIMITED AMOUNT. END SUMMARY.

2. BALANCE OF PAYMENTS ESTIMATES FOR 1974 REFLECT CONTINUATION OF DETERIORATION REPORTED (REF B). ALTHOUGH EXPORT PERFOR-
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MANCE BETTER THAN EXPECTED, IMPORTS REACHED LEVEL MUCH HIGHER

THAN ANTICIPATED, RESULTING IN CURRENT ACCOUNT DEFICIT OF \$3.6 BILLION. CAPITAL ACCOUNT WEAKENED MARKEDLY IN 1974 FROM PREVIOUS YEAR. UNILATERAL TRANSFERS DECLINED BY \$425 MILLION WITH INSTITUTIONAL TRANSFERS (INCLUDING UJA) RESPONSIBLE FOR ALMOST ENTIRE DECLINE. ISRAEL BOND SALES DECREASED BY ALMOST \$200 MILLION TO \$310 MILLION DESPITE SANGUINE FORECASTS OF \$400 MILLION BY GOI AND OVER \$500 MILLION BY THIS EMBASSY AT BEGINNING OF YEAR. FOREIGN INVESTMENT WAS DOWN TO ONLY \$50 MILLION AS RESULT OF WORLD ECONOMIC DOWNTURN, MID-EAST TENSION AND WITHHOLDING OF FUNDS BY INVESTORS IN EXPECTATION OF THE NOVEMBER 10 DEVALUATION. FOREIGN EXCHANGE LEVEL \$ ONE BILLION FOR 1974 REPORTED IN BLUE PAPER, TABLE II, INCLUDES APPROXIMATELY \$500 MILLION COMMERCIAL BORROWING WHICH REDUCED UNCOVERED DEFICIT FROM \$1,229 MILLION FOR 1974 SHOWN IN TABLE I TO ABOUT \$729 MILLION, WHICH APPROXIMATES THE DECLINE IN FOREIGN EXCHANGE RESERVES DURING 1974.

3. PROJECTIONS FOR 1975 ARE GLOOMY. UNDERLYING ASSUMPTION IS STATE OF NO WAR BUT CONTINUATION OF TENSION AND MOBILIZATION AT LEVEL PREVAILING LAST THREE-QUARTERS 1974. ADDITIONALLY, IT IS ASSUMED THAT GNP WILL INCREASE BY THREE PERCENT AND THAT EXPORTS WILL INCREASE BY 10 PERCENT IN REAL TERMS WHILE IMPORTS DECREASE BY ONE PERCENT IN REAL TERMS. UNILATERAL TRANSFERS ARE PROJECTED TO INCREASE SLIGHTLY OVER 1974 AND FOREIGN INVESTMENT IS ESTIMATED TO REACH \$100 MILLION. ISRAEL BOND SALES ARE PROJECTED TO INCREASE SLIGHTLY AND LONG AND MEDIUM-TERM BORROWING IS ESTIMATED TO REACH \$650 MILLION. THE \$190 MILLION PROJECTION FOR WORLD BANK AND IMF CONSISTS OF ADDITIONAL CREDIT TRANCHE OF \$40 MILLION AND TWO LOANS OF \$75 MILLION EACH FROM PROPOSED IMF OIL FACILITY. US ASSISTANCE IS ESTIMATED AT \$1,571 MILLION WHICH INCLUDES UNSPENT PREVIOUS YEARS' MILITARY CREDITS. DESPITE THIS MASSIVE DOSE US ASSISTANCE, GOI PROJECTS SHORTFALL OF \$784 MILLION IN BALANCE OF PAYMENTS. WHILE FOREIGN EXCHANGE RESERVES WERE DRAWN DOWN IN 1974, DECISION WAS REACHED TO MAINTAIN MINIMUM LEVEL OF \$1 BILLION WHICH REPRESENTS LESS THAN TWO MONTHS' IMPORTS. WE WOULD NOTE HOWEVER THAT FOREIGN EXCHANGE COSTS OF OIL IMPORTS IN 1975 ARE PROJECTED AT \$330 MILLION, NOT \$600 MILLION SHOWN IN BLUE PAPER. LATTER FIGURE INCLUDES "IMPORTED" OIL FROM SINAI.

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4. PAPER DESCRIBES IN SOME DETAIL GOI'S THREE MAIN EFFORTS SINCE OCTOBER 1973 TO REDUCE HYPERACTIVITY OF ECONOMY, INFLATION AND DRAIN ON FOREIGN EXCHANGE RESERVES. RESULTS HAVE BEEN LIMITED. IN 1974, GNP STILL GREW BY 5 PERCENT (IN REAL TERMS) AND PRIVATE CONSUMPTION BY 6.5 PERCENT (DURING FIRST NINE MONTHS). PRICES ROSE IN 1974 SOME 50 TO 60 PERCENT, ALTHOUGH ALMOST HALF OF PRICE RISE WAS DUE TO NOVEMBER 10 DEVALUATION MEASURES. MOREOVER, PROSPECTS FOR ECONOMIC

STABILIZATION IN FUTURE REST TO MAJOR EXTENT ON SUCCESS GOI
POLICY OBJECTIVES OF GETTING HISTADRUT AGREEMENT TO EXTEND
EXISTING LABOR AGREEMENTS FOR REMAINDER OF YEAR AND FOREGOING
ANY COST-OF-LIVING ALLOWANCE INCREASES BEGINNING JULY ATTRIBUTABLE
TO NOVEMBER 10 ECONOMIC PROGRAM (REF C). HISTADRUT POSITION
WILL BE HEAVILY INFLUENCED BY EXTENT OF ANY INCREASED UNEMPLOY-
MENT WHICH MAY DEVELOP BY MID-1975 PLUS RESPONSIVENESS OF
GOI TO HISTADRUT PROPOSALS FOR TAX REFORM. TO EXTENT THAT
THESE GOI POLICY OBJECTIVES ARE NOT REALIZED AND COLA PAYMENTS
PLUS INCREASED GOVERNMENT EXPENDITURES CONTRIBUTE TO INFLA-
TIONARY PRESSURES, GOI PROJECTIONS OF AUSTERITY ARE NOT TENABLE.
IN ADDITION, PRESSURES TO AVERT UNEMPLOYMENT MAY ALSO CON-
TRIBUTE TO INFLATION. WHILE PAPER STATES THAT PRIVATE CONSUMPTION
WILL DECLINE IN 1975, AND FINANCE MINISTER SPECIFIES THAT DECLINE
WILL BE 5 PERCENT PER CAPITA, WE DOUBT THAT GOI WILL BE ABLE
FREEZE PRIVATE CONSUMPTION AT 1974 LEVELS, LET ALONE
REDUCE IT.

5. WITH REGARD ECONOMIC PROJECTIONS FOR 1976, IMPORTS ARE
ESTIMATED TO INCREASE 9 PERCENT AND EXPORTS 17.5 PERCENT
FOR CURRENT ACCOUNT DEFICIT OF \$3.7 BILLION, WHICH IS VIR-
TUALLY SAME DEFICIT AS IN TWO PREVIOUS YEARS. EXTERNAL
DEBT SERVICING IS FORECAST TO RISE TO \$820 MILLION. TOTAL
UNILATERAL TRANSFERS ARE FORECAST AT 1975 LEVEL, WHICH
MAY BE HIGHLY QUESTIONABLE ASSUMING ECONOMIC RECOVERY IN US AND
WESTERN EUROPE AT LATEST BY EARLY 1976. NET FOREIGN
INVESTMENT IS EXPECTED TO REACH \$120 MILLION. PROCEEDS
FROM ISRAEL BONDS ARE ALSO PROJECTED AT THE 1975 LEVEL
WHICH MAY ALSO BE TOO PESSIMISTIC IN EMBASSY'S VIEW. LONG
AND MEDIUM-TERM LOANS (EXCLUDING ISRAEL BONDS AND US
AID) ARE FORECAST AT \$540 MILLION, WITH DECREASES IN
BOTH WORLD BANK AND COMMERCIAL BORROWING. BALANCE OF
PAYMENTS GAP OF \$2.59 BILLION IS THEREFORE PROJECTED
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FOR 1976. PAPER REQUESTS FULFILLMENT OF THIS GAP WITH
FOLLOWING US ASSISTANCE: SPECIAL MILITARY SALES
CREDITS AND GRANTS \$1,500 MILLION; REGULAR FMS \$300
MILLION; PL-480 OR SIMILAR SCHEME \$250 MILLION;
AID HOUSING GUARANTEE \$50 MILLION; SOVIET REFUGEE ASSIS-
TANCE \$100 MILLION; SUPPORTING ASSISTANCE " IN AMOUNT
NOT LESS THAN FY-75 GRANT" FO \$325 MILLION.

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ACTION SS-25

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FM AMEMBASSY TEL AVIV

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6. REQUEST FOR \$250 MILLION FOR PL-480 OR OTHER FINANCING OF COMMODITY PURCHASES APPEARS TO BE PARTICULARLY UNREALISTIC, IN HIGH SHORT US SUPPLY SITUATION AND APPROVAL SO FAR OF ONLY \$9 MILLION IN PL-480 CREDITS FOR FY-75. COMMODITY FINANCING, INCLUDING FINANCING OF OIL AND STORAGE FACILITIES, IS ALSO BEING PURSUED IN US/ISREL JOINT COMMITTEE FRAMEWORK. WE HOPE THAT WAY CAN BE FOUND TO MEET THEIR REQUESTS IN THESE CATEGORIES, AT LEAST PARTIALLY SINCE THERE IS REAL NEED AND, AS IN CASE OF MILITARY EQUIPMENT, WE ARE FINANCING EXPORT OF US COMMODITIES AND PRODUCTS.

7 BUT KEY ELEMENT IN PAPER IS REFERENCE TO EARLIER GOI REQUESTS TO PRESIDENTS NIXON AND FORD FOR MILITARY ASSISTANCE IN AMOUNT OF \$1.5 BILLION PER YEAR OVER NEXT THREE FISCAL YEARS. THIS \$4.5 BILLION TOTAL REPRESENTS ESTIMATED DIRECT PROCUREMENT THROUGH US DEPARTMENT OF DEFENSE AND IS IN ADDITION TO REGULAR FMS OF \$300 MILLION REQUESTED ANNUALLY TO FINANCE MILITARY PURCHASES FROM US FIRMS. USG IS AGAIN ASKED TO REQUEST FROM CONGRESS LEGISLATIVE AUTHORIZATION FOR THIS \$4.5 BILLION MULTI-YEAR PROGRAM. THESE ARE STAGGERING FIGURES AND, APART FROM WHETHER MULTI-YEAR AUTHORIZATION IS FEASIBLE OR NOT, OBVIOUSLY MUST RECEIVE CLOSEST SCRUTINY BY USG, GAUGING ISRAEL'S PERCEIVED DEFENSE REQUIREMENTS IN CONTEXT MIDDLE EAST DEVELOPMENTS AND US POLICY OBJECTIVES.

8. AS REPORTED ON JANUARY 9 (REF A), I TOLD FINANCE MINISTER RABINOWITZ THAT MEETING ISRAELI AID REQUEST IN

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FULL WOULD BE MIRACULOUS GIVEN CIRCUMSTANCES PREVAILING IN US. BUT I ALSO ASSURED HIM THAT THEIR REQUEST

WOULD RECEIVE FULL AND SERIOUS CONSIDERATION IN KEEPING
WITH OUR COMMITMENT TO ISRAEL'S SECURITY AND CONTINUED
VIABILITY.
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